

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

WATER DIVISION  
Water Branch

RESOLUTION W-4554  
August 25, 2005

**R E S O L U T I O N**

**(RES. W- 4554), RURAL WATER COMPANY, SEWER SERVICE (Rural).  
ORDER AUTHORIZING A THIRTY-SIX MONTH RATE  
SURCHARGE FOR RECOVERY OF ITS UNANTICIPATED EXPENSE  
MEMORANDUM ACCOUNT PRODUCING AN ANNUAL  
INCREASE OF \$ 25,289 OR 15.2% FOR A TOTAL OF \$75,867.**

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**SUMMARY**

By Advice Letter 2, dated February 14, 2005, Rural seeks to recover unanticipated expenses for repair of its sewage treatment plant. Recovery would require revision of Tariff Schedules Nos. 1, Residential Flat Rate Sewage Service and 2, Commercial Flat Rate Service. This Resolution authorizes Rural to implement a surcharge of 15.2% applied to each rate category for flat rate customers for a thirty-six month period to recover costs booked to its Unanticipated Expense Memorandum Account. The surcharge amounts are shown in Appendix A.

**BACKGROUND**

Decision 92-03-093, dated March 31, 1992, authorized Class C and Class D water utilities to establish a memorandum account to track unanticipated costs of repairs and to notify the Water Division (Division) when it has done so. Resolution (Res.) No. W-4467, dated April 22, 2004, extended the protection provided by the unanticipated repair cost memorandum account to Class C and D sewer utilities.

Rural informed the Division in November 2003 and later by letter dated May 20, 2004, that substantial unanticipated non-budgeted operating costs increased rapidly in 2004. Specifically: increases in non-labor fixed rates, unexpected breakdown of mechanical components, and excessive buildup of sewage by-product "liquefied sludge" that could not meet "tertiary" water quality standards for disposal into onsite irrigation ponds. In response to a letter dated May 20, 2004, Division directed Rural to track the expenses associated with the operating costs in a separate account and to request recovery upon completion of the project.

In its Advice Letter 2, Rural requested to recover the memorandum account balance of \$143,824.18 with a surcharge of 91% per month per connection for a period of 12 months.

Rural presently provides service to approximately 318 flat rate sewer customers in a service area located at Cypress Ridge Parkway, near the city of Arroyo Grande, in San Luis Obispo County. Rural's last general rate increase was approved on June 6, 2002, by Dec. No. 02-06-005, which authorized a return of \$24,680 or 15% rate of margin.

### **NOTICE AND PROTESTS**

Notice of the rate increase was published in the local newspaper on February 14, 2005. The Division received twenty letters protesting the rate increase. The topics covered by the customer letters include; the impact of the increase on fixed income residents, the questioning of the new owner's operation of the sewage treatment plant, and the unexpected nature of these additional expenses.

On Wednesday, April 26, 2005 at 10:00 am, a public meeting was held in the utility's service area. Division's representative explained Commission rate setting procedures and Rural's representative explained the reasons for the proposed increase. Representatives from the Homeowners Association, Development Company, and Consultants also made presentations. Approximately sixty customers attended the meeting. The customers made statements, asked questions, registered complaints, or made miscellaneous comments related to utility operations. Some of the customers, who spoke at the meeting, protested the magnitude of the increase. Attachment 1 includes a memorandum summarizing what was discussed in the meeting.

Division representative assured customers that the Commission would take into account all of the customers concerns when authorizing the final rates in the matter.

### **DISCUSSION**

The increase requested herein is for the purpose of recovering through a surcharge, on a dollar-for-dollar basis, expenses which Rural incurred in unanticipated expenses related to operations of its sewage treatment plant. In Decision 92-03-093, the Commission authorized Class C and D water companies to establish memorandum accounts for unanticipated expenses. Res. W-4467 extended the protection provided by the unanticipated repair cost memorandum account to Class C and D sewer utilities.

Decision 92-03-093 states: "Branch's proposal at hearing would permit small water companies (Class C and D) to establish by advice letter a similar memorandum account for unanticipated repair costs that are not already reflected in rates. It would be limited

to costs that are (1) unanticipated, and (2) crucial to the operations of the utility. Costs to correct heavy damage due to an unusual freeze would be one example of likely recovery. Repair of a failed water pump, where the failure could not have been foreseen or prevented and the repair costs are not already included, would be another example.”

Fluid Resources Management (FRM) began operating the wastewater facility for Rural in 2002, and previously operated the facility for the developer since 1999. FRM informed Rural that as of June 30, 2005, FRM will no longer be operating the wastewater treatment facility. The costs for the operations and maintenance sharply increased due to the sludge removal. The facility was initially designed for a projected daily flow volume of 80,000 to 90,000 gallons. However, actual flows at the facility are between one-half and one-third of the design flow and the community is almost fully developed. The low volume of wastewater results in less organic material (bacteria) for the biological processes in the system. The low flow creates sewage solids or sludge with poor settling characteristics, which must be periodically removed from the system. Only a negligible amount of sludge was removed in the four years from 1999 to 2003. The accumulated material resulted in significantly higher level of total sludge removal in 2004. The sludge is currently hauled offsite to the Avila Beach Sewage Treatment Plant (STP). The General Manager of Avila Beach STP is John Wallace, who is also the President of FRM.

Rural relied solely on FRM contracted operational engineers on site to operate the sewage treatment plant. Rural believed that FRM would modify programmed parameters to the control system based on operational input from the manufacturer. FRM was not the original design engineering company for the plant. In other wastewater systems, there is sludge dewatering equipment available to handle excessive sludge, such as passive drying beds, lined beds, and belt press devices. Rural does not have sludge dewatering equipment and therefore is completely dependent on biological processes.

Rural believed that the sewage plant operations would stabilize through a combination of system optimization by the operational engineers with higher flows when more residents came on-line. The operations did not stabilize and as a result, the average monthly cost for sludge removal services was \$21,595 during this period (April 22, 2004 to December 31, 2004) as compared to an estimated cost of \$6,898 when the Commission set the rates for sewer service.

Faced with mounting losses as a result of substantial increases in sludge hauling costs, on February 3, 2005, Rural met with Gary Kalar of EcoSystems Design and Development (Consultant) to review the sewage plant and its operations. During the period of February to April 2005, the sewage plant's operations stabilized. The average

monthly cost for the contract work category, which includes sludge removal, was \$14,583 for this period.

The Consultant's finding was that the plant was being operated far from design parameters. The plant was being operated in a dual tank mode with a large buildup of filamentous growth caused by a lack of nutrients in the low flows. This resulted in large quantities of sludge which needed to be hauled off because there was minimal sludge breakdown. Since the community consists mostly of retirement homes, the flows have averaged out to be less than 1/3 the original flow design of 140,000 gals/day. The Consultant concluded that there is no need for great amounts of sludge haul-off if the plant is operated per the guidelines given.

Division finds the EcoSystems Design and Development's finding to be reasonable and therefore the difference in the monthly cost (\$14,583) for the February to April 2005 period and the original GRC monthly cost (\$6,898), which is \$7,685, plus the one time consultant fee (\$11,690) is annualized for the period Rural is requesting recovery. The total recovery amount is  $(8.35 \times \$7,685) + \$11,690 = \$75,867$ . Therefore, Division determined that the company should be allowed to recover the non-budgeted operating expenses. The company will not recover expenses for the time period prior to April 22, 2004.

Rural believes that it cannot sustain another loss year and therefore requests approval of this memorandum account recovery. Adoption of this resolution would allow Rural to operate with any additional shortfalls until the next general rate case is filed. The Homeowners Association (Association) oppose any rate surcharge and expressed this opinion during the Public Meeting (Memorandum of Public Meeting attached in Appendix B). The Association "raised issues of competence, including a perceived lack of reasonable corrective action". They also requested that the Commission reconsider the test year for the general rate case the company is allowed to file per the latest Decision due to the belief that operations are not stabilized and operating costs would be based on plant operations that are not yet stabilized.

Division has reviewed Rural's last general rate increase and believes that Rural could not have anticipated the expenses and, therefore, did not receive enough revenue for the recently incurred expenses to operate their sewage treatment plant. The unanticipated expenses were in the contract work category were: 1) increases in non-fixed labor rates, 2) unexpected breakdown of mechanical components, and 3) excessive buildup of sewage by-product "liquefied sludge" that could not meet tertiary water quality standards for disposal into onsite irrigation ponds. Over 850,000 gallons had to be trucked to other local sewage treatment plants for processing.

Division reviewed Rural's expenditures recorded in its unanticipated expenses memorandum account and found them reasonable. Division investigated the billings and expenses for the sewer company for the time period listed as well as the 2004 period under review. Division agrees with the Consultant's analysis that the plant was being operated far from design parameters. However, Rural contracts the sewer operations to another company, and this company is not the original design engineers for the system.

Division requested additional information from Rural for year 2005 for the contract work category. Division believes that Rural's formal actions to remediate the plant issues in 2005 provide a basis of comparison for earlier action. In other words, the EcoSystems Design and contractors determined early in 2005 that the system was not running efficiently and began the process of optimizing the system. However, the steps implemented resulted in similar operational expenses for contract work which exceeded the original amount approved for this category in the last general rate case. Even if earlier actions were initiated by Rural, the unanticipated expenses would remain approximately the same. Therefore, Division determined that the company should be allowed to recover the non-budgeted operating expenses. The company will not recover expenses for the time period prior to April 22, 2004.

Rural requested to recover the memorandum account in a 12-month period. Since the requested increase exceeds 10% of the last authorized revenue requirement, Standard Practice U-27-W prescribes that recovery be spread over 36 months. Using this prescribed period will make the surcharge more affordable for the customers and will not unduly burden Rural. Therefore, the Division recommends a 36-month recovery period.

Rural's request was to apply an equal surcharge amount to each service connection. The recommended surcharge is 15.2%, a fixed percentage of the existing tariff rates, applied to each rate category for flat rate customers. The surcharge rates are shown in Appendix A. The Division recommends that Rural be required to track revenues collected under the surcharge and refund any excess revenues collected to the ratepayers.

Rural followed the prescribed procedure by timely advising the Division in writing of the need for the memorandum account on May 20, 2004. Using Rural's 2004 Annual Report, the Division determined that Rural did not exceed their authorized rate of margin on a recorded basis. The increase will not result in a rate of margin greater than last authorized for Rural.

Rural has no outstanding Commission orders.

## **COMMENTS**

Code §311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Code §311(g)(2) provides that this 30-day period may be waived or reduced upon stipulation of all parties in the proceeding.

The 30-day comment period for the draft resolution was neither waived nor reduced. Accordingly, this draft resolution was mailed to parties for comments, and will be placed on the Commission's agenda no earlier than 30 days from the date of mailing of this resolution to the parties.

Comments were received from the Cypress Ridge Owner's Association (Association) on August 12, 2005. Association disagreed with Division's calculations of the total recovery amount. Association argues that the total recovery amount should not include expenses prior to April 22, 2004, the date Res. W-4467 extended the protection provided by the unanticipated repair cost memorandum account to Class C and D sewer utilities. Division revised the total recovery amount to reflect Association's concern.

## **FINDINGS**

1. The Commission finds, after investigation by the Division, that the rate surcharge hereby authorized is justified and the resulting rates are just and reasonable.

## **THEREFORE IT IS ORDERED THAT:**

1. Authority is granted under Public Utilities Code Section 454 for Rural Water Company to file a supplement advice letter incorporating the revised schedules attached to this resolution as Appendix A, and concurrently to cancel its presently effective rate schedules Nos. 1, Residential Flat Rate Sewage Service, and 2, Commercial Flat Rate Service. Its filing shall comply with General Order 96-A. The effective date of the revised schedules shall be five days after the date of its filing.
2. Rural Water Company shall track the revenue from the surcharge in a balancing account as required by Public Utilities Code § 792.5. <sup>1</sup>

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<sup>1</sup> **Public Utilities Code 792.5 states:**

Whenever the commission authorizes any change in rates reflecting and passing through to customers specific changes in costs, except rates set for common carriers, the commission shall require as a condition of such order that the public utility establish and maintain a reserve account reflecting the balance, whether positive or negative, between the related costs and revenues, and the commission shall

*Footnote continued on next page*

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take into account by appropriate adjustment or other action any positive or negative balance remaining in any such reserve account at the time of any subsequent rate adjustment.

3. This resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on August 25, 2005; the following Commissioners voting favorably thereon:

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STEVE LARSON  
Executive Director

MICHAEL R. PEEVEY  
President  
GEOFFREY F. BROWN  
SUSAN P. KENNEDY  
DIAN M. GRUENEICH  
JOHN A. BOHN  
Commissioners



**APPENDIX A**  
**Sheet 1**  
**RURAL WATER COMPANY**  
**SEWER Service**

**Schedule No. 1**

**RESIDENTIAL FLAT RATE SEWER SERVICE**

**APPLICABILITY**

Applicable to all residential sewer service.

**TERRITORY**

Cypress Ridge, within tract 1933, and including Golf Course Complex,  
San Luis Obispo County.

**RATES**

	<u>Per Connection</u> <u>Per Month</u>	<u>Surcharge</u> <u>Per Month</u>
For all residential sewer service.....	\$44.03	\$ 6.47 (N)

**SPECIAL CONDITIONS**

1. All bills are subject to the reimbursement fee set forth on Schedule No. UF.
2. All sewer service is subject to a surcharge of \$ 6.47 for a period of 36 months beginning the effective date of the advice letter. (N)  
(N)

**APPENDIX A**  
**Sheet 2**  
**RURAL WATER COMPANY**  
**SEWER Service**

**Schedule No. 2**

**COMMERCIAL FLAT RATE SEWER SERVICE**

**APPLICABILITY**

Applicable to all residential sewer service.

**TERRITORY**

Cypress Ridge, within tract 1933, and including Golf Course Complex,  
San Luis Obispo County.

**RATES**

Service Charge:		<u>Per Connection</u> <u>Per Month</u>	<u>Surcharge</u> <u>Per Month</u>	
For	Golf Pro Shop	\$29.50	\$ 4.34	(N)
For	Golf Maintenance Facility	\$71.55	\$ 10.52	
For	Commercial/Office Facility	\$58.99	\$ 8.67	
For	Pavilion	\$58.99	\$ 8.67	(N)

The service charge is a readiness-to-serve charge which is applicable to metered service and to which is added the monthly charge computed at the Quantity Rate.

**SPECIAL CONDITIONS**

1. All bills are subject to the reimbursement fee set forth on Schedule No. UF.
2. All sewer service is subject to a surcharge as shown for a period of (N)  
36 months beginning the effective date of the advice letter. (N)

**APPENDIX B**

**DISTRIBUTION**

F. L. Curry, Chief  
M. Kazemzadeh, Supervisor  
Eric Chiang, Utilities Engineer

**PREPARED BY:**

Eric Chiang  
Utilities Engineer  
Date: April 26, 2005

**MEMORANDUM OF PUBLIC MEETING**

**Subject:** Informal Public Meeting concerning Advice Letter Request for  
Unanticipated Operating Expense Surcharge request by Rural Sewer  
Company (Rural)

**Held at:** Cypress Ridge Pavilion,  
Arroyo Grande, CA

**Date:** Wednesday  
April 20, 2005  
**Time:** 10:00 a.m.

**Present:**

<u>Name</u>	<u>Title</u>	<u>Representing</u>
Fred Curry	Program Manager	CPUC Staff
Eric Chiang	Utilities Engineer	CPUC Staff
Chuck Baker	Owner Operator	Rural
Dennis Sullivan	President	Cypress Ridge Development Corp.
John Wallace	President	Fluid Resource Management
Robert Miller	Division Manager	FRM
Chuck Ellison	General Manager	FRM
Chris Nally	Operations Manager	FRM
Gary Kalar	President	EcoSystems Design & Development
Steve Martinez	Board of Director Member	Cypress Ridge Owners Assoc

Notice of the meeting was mailed to the ratepayers on March 23, 2005. The meeting began at 10:10 a.m. with approximately 60 customers present. Rural provides sewer service to approximately 325 flat rate customers.

Mr. Curry explained the purpose of the meeting and Commission procedures.

Mr. Steve Martinez, a board member of the Cypress Ridge Owners Association (CROA) represented the homeowners and gave a presentation questioning the need for the rate surcharge. He explained the homeowner association's concerns regarding issues with the proposed surcharge. Overall, the association questioned the need for the surcharge itself. Mr. Martinez raised issues of competence, including a perceived lack of reasonable corrective action when the sewer plant first encountered problems. There were questions regarding Mr. John Wallace's dual role as a consultant for Fluid Resource Management, Inc. (FRM) and general manager of the Avila Beach Wastewater disposal site. There were complaints about the general lack of communications with the customers, specifically the initial notice to customers not being sent to customers and instead being placed in a newspaper of general circulation. Mr. Martinez also requested that the CPUC reconsider the test year for the general rate case the company is allowed to file per the latest Decision. He believes that the operations are not stabilized and not operating in a reasonable manner for the current test year. In summary, the homeowners association opposes any increase because they believe that reasonable diligence was not performed and the operational problems associated with the sludge disposal were avoidable.

Mr. Curry explained the application process, advice letter process, and data requests sent to Rural. CPUC staff discussed in general the ratemaking process and the inspection of company records during the process. Mr. Curry also reiterated that a test of reasonableness is applied to the requested amount and the utility's handling of the issue over time. He also mentioned that Resolution No. W-4467 in April 2004 extended memorandum account setups to sewer companies, however there is no guarantee of recovery because there is a just and reasonableness criteria that needs to be established. In other words, were the unanticipated expenses within the utility's control?

Mr. Baker stated that he might have been abandoned the system if Res. No. W-4467 had not been established. He reaffirmed the last decision in A.01-02-016 that allowed him to file a GRC for the sewer portion of the company for test year 2005. Mr. Baker went on to state that the sewer and water expenses, such as power, of the company were separated. He needs the surcharge now, as the current burden of the expenses is unbearable and he cannot wait until a GRC is filed and completed to recoup his losses.

Mr. Wallace was the next speaker and he explained FRM's role in the sewer company's operations. FRM is basically the operator of the facilities only, they were not the design engineers nor are they involved with any financial bookkeeping services for Rural. The original engineering design firm, Mauldin Dorfmeier, who provided operations manuals for Rural, is no longer in business. Jet Tech and Integrated Controls (JTIC) is a vendor and process specialist company which provides sewage treatment supplies.

Mr. Miller continued the presentation for FRM by explaining the plant diagram and sludge problem. He went on to say that Rural has met all Regional Water Quality Control Board standards to date. Essentially the design parameters overstated the amount of sewage usage based on the demographics of the neighborhood community. Mr. Miller then provided a treatment facility overview which included the following topics: design flow and loading, influent lift stations and grinders, sequencing batch reactors, filter, chlorination and discharge, aerobic digester.

Mr. Ellison was brought on to explain the operational history of the plant. His presentation including the following topics: start up and manual operation, increase in flows and manual mode, involvement from vendor and process specialist JTIC, process and equipment challenges – chronology, facility compliance with discharge orders, and operational adjustments since February 2005. He went on address the main concern of meeting: effluent quality standards and hauling of the sludge and the associated costs.

Mr. Miller continued the presentation by touching on the wastewater facility challenges: facility under loading, limit guidance in operations and maintenance manual, solid handling facility, second party input and capital improvements, timing of process and facility adjustments. FRM also expressed goodwill by indicating openness to oversight and input by the home owners.

The next topic was the sludge handling costs which included information on the following: original estimates assumed dense sludge and efficient operations, cost compounded by disposal fees, solids dewatering part of solution, efficient biological action important. It was mentioned that there are no other facilities in the area to handle the sludge removal except for the City of Santa Maria, and their costs are higher than Avila Beach's.

FRM's last presentation proposed the next steps which included: negotiate an acceptable and responsible surcharge, retain 3<sup>rd</sup> party engineer and install improvements, improve on-going communications with the homeowners association. FRM stated that they have an incentive to further reduce sludge removal costs because of the fixed labor contract with Rural. FRM concluded by saying they look forward to a

long-term relationship with the community. They did not create the problem but are willing to share in the burden to resolve it.

Mr. Sullivan spoke on behalf of the potential future users as the President of the Cypress Ridge Development Corporation (CRDC). He wanted to ensure that service is always available at a predictable price, because the sewage treatment plant is currently not operating in a stable and predictable manner, although he acknowledged that there are no compliance issues with the quality of the effluent. He indicated that there are no facility engineers on site, only operational engineers. The plant was paid for and donated to Mr. Baker, owner-operator of Rural, six years ago, so it is still relatively state-of-the-art. Mr. Sullivan believes that the fairly new community is not interested in becoming part of the Nipomo city district/limits. He mentioned that a proposal has been made to Mr. Baker to delay the GRC filing until 2008 while CRDC funds a project to stabilize the sewage treatment plant operation. CRDC will pick up the engineers' expense and the capital improvements proposed in the project.

The balance of the meeting consisted of comments and questions by the customers.

One customer wanted to know if there is a precedent similar to this situation. Mr. Curry replied that no sewer company has requested this type of recovery since 1989. However the memorandum account recovery was established in 1992 for small water companies and not until 2004 for sewer companies.

Another customer asked when Rural last filed for a GRC and the procedures the CPUC has in place for rate increases. Mr. Curry explained the application process, advice letter process, and data requests sent to Rural. CPUC staff discussed in general the ratemaking process, and the inspection of company records during the process.

Another customer questioned the need to use Rural as the utility service provider based on their mailing address. This person believes that the city mailing address of Arroyo Grande instead of Nipomo has no relation to the sewer service provider chosen for the community. FRM responded with examples of rates for other sewer service providers in the area showing that the Rural's rates are competitive, if not cheaper, than others in the nearby areas.

This customer also questioned the consequences of "abandonment" and in general, the finite human life span of Mr. Baker. Mr. Curry responded that the Commission would recommend a receivership and only one water utility has been abandoned and that one was given to the customers to run.

There were specific questions regarding the sludge problem. Multiple parties responded on the technique of the drying of the sludge and the cost effective way to

handle. Also, the cost alternatives of running the sewer operations manually versus an automatic device and the under-loaded effects of the preferred mode were explained.

Mr. Sullivan then presented some specific information regarding a possible agreement with Rural. There would be a surcharge of \$12/month for 36 months (\$143,824) and this also allows for inflation at approximately \$35,000/year. The Cypress Ridge Development Corp. would bring in a 3<sup>rd</sup> party engineer to upgrade the plant. Rural would then agree to use 2007 as a test year for new rates in 2008. He mentioned that all of this depends on CPUC acceptance of the surcharge, the amount, and the recovery time period.

Another customer with almost 40 years of civil engineering wastewater experience volunteered to assist with the project to optimize the plant operations. He stated that operator FRM may have had limited access to adequate process engineer advice due to contractual setups. Since the original design engineering firm is no longer in business and the vendors are not paid to give process advice, there has been a general absence of advice on correcting problems and operating efficiently.

Another customer wondered if the ratepayers should pay anything at all if it is determined the problems are as a result of negligence. Also he asked if there is some sort of insurance that would cover these problems. Mr. Curry responded that it is the Commission's job to determine the reasonableness and justification for any rate request.

In general, customers were concerned about the overall "transparency" of the request to raise rates by Rural. Mr. Curry assured the home owners that the Commission must, by law, send out all information for a requested rate action to the service list for customers to review and comment for thirty days. Once the resolution is completed, the homeowners association would receive a copy to pass onto all their members for review and comment.

The meeting was adjourned at about 12:30 P.M.